SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 126

JEROME S. MURRAY and GRACE H. MURRAY, *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITIONERS' REPLY TO MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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In the petition for certiorari, *Scheuber* v. *Commissioner,* 7 Cir., 371 F. 2d 996 (1967), was cited as being in conflict with the decision of the Fourth Circuit in the instant case. In fact, in theAmerican Bar Association Journal, September 1967, the *Scheuber* case is referred to as the first Court of Appeals case to apply the principles laid down in *Malat* v. *Riddell,* 383 U. S. 569.[1] Since the *Scheuber* decision, two other Circuit

[1] *Tax Notes,* 53 A.B.A.J. 863.

Courts have recently spoken on the application of the *Malat* principles, namely, *Joan E. Heller Trust, et al.* v. *Commissioner,* 9 Cir. (8/24/67), —— F. 2d ——, 67-2 USTC ¶ 9626, and the *Municipal Bond Corporation* v. *Commissioner,* 8 Cir. (9/1/67), —— F. 2d ——, 67-2 USTC ¶ 9633. These two recent decisions reflect a unanimity of views between the Seventh, Eighth and Ninth Circuits since they are clearly in agreement with *Scheuber*. Thus, the decision below stands alone in sanctioning principles which conflict with those enunciated in *Malat* v. *Riddell, supra.*

The respondent states that the Fourth Circuit affirmed the Tax Court's decision, finding it "consistent with this Court's intervening opinion in *Malat* v. *Riddell,*" (p. 2). The petitioner and the Court would be much more enlightened as to the Fourth Circuit's views of the *Malat* principles as they applied to the instant case had an explanatory opinion accompanied its decision. Likewise, such an opinion of the Court below would have left no doubt as to its views with respect to application of *Arrowsmith* v. *Commissioner,* 344 U.S. 6, with respect to fixing the character of the transaction in the year of sale.

Since the Seventh, Eighth and Ninth Circuits have found it necessary to reverse the Tax Court by reason of the principles laid down in *Malat* v. *Riddell,*[2] the older cases which predated *Malat* v. *Riddell,* cited in respondent's brief in opposition, are of doubtful value.

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[2] In the *Municipal Bond Corporation* case, *supra,* it is the second reversal, the first being reported at 341 F. 2d 683, cited in the petition herein (pp. 10, 13) and in the opposing memorandum (p. 7). It is significant that the Tax Court opinion following the first remand was entered after the *Malat* decision, and the second reversal by the Eighth Circuit was for failure to apply the *Malat* principles.

With particular reference to the Gordon Contract, the respondent refers to the absence of rental or other investment income (p. 4) and to petitioner's "self-serving testimony" (p. 5) as to his intended use of the property. He also refers to the lack of any attempt to secure investment income from the property (p. 6) as another reason for the Tax Court's holding "that the rights to the Gordon property had been held primarily for sale in the ordinary course of business (R. 53-54)" (p. 6). Bearing in mind that it was the contract which the petitioner sold, not the land covered by the contract of sale, it is difficult to understand how, under the circumstances, he could possibly have carried out any intentions he had as to the use of the land. He sold the contract without ever acquiring title to the land. For the same reason, the petitioner was never in any position to obtain "investment income" from the property.[3]

In both *Joan E. Heller Trust, supra,* and *Municipal Bond Corporation, supra,* the respective Circuit Courts noted error in that the conclusion of the Tax Court was not supported by the facts. The instant petition, as the fourth reason for granting certiorari (p. 10), alleges a similar error, which also was raised below in the Petition for Rehearing (App. C, Point I, ¶1), which was summarily denied.

In its memorandum in opposition, the Government speaks of the "number" of sales made by the taxpayer (p. 3).

During the years 1950 through 1963 considered by the Tax Court, the taxpayer made a total of 26 sales.

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[3] *Malat* v. *Riddell* imposes no requirement that real property held for investment must be income-producing.

Excluding the three sales under threat of condemnation (R. 42-43, 62-68) and the sale at cost to Georgetown University (R. 39-42, 60-62), the taxpayer made 22 sales during a period of 14 years, or an average of a little better than one and a half sales a year, and these properties had been held—on an average—about ten years.

All but four of these sales were held by the Commissioner of Internal Revenue or by the Tax Court to result in capital gains. These *four* are the "numerous sales" relied on by the Tax Court in finding the taxpayer to be in a business (R. 49-50).

Four sales in 14 years can scarcely result in the "busyness"[4] needed for a dealership status or in the "everyday operation of a business."[5]

The respondent gives short shrift to petitioner's third reason for granting the writ (p. 8), namely, failure to give effect to *Arrowsmith* v. *Commissioner,* 344 U.S. 6 (1952). He would have it appear that the Commissioner passively failed to challenge the treatment of the Gordon Contract sale as a capital transaction in the year of sale (1955), hence his inaction did not evidence his agreement that it was the sale of a capital asset (p. 7). However, the Commissioner took affirmative action for the year of sale. Not only did he recompute the long-term capital gain from $1,890,000, as reported, to $1,875,062.06, as corrected; but by reason thereof, he determined an overpayment and made a refund for 1955, as found by the Tax Court (R. 23). See also Ex. 8-H, p. 11. Cf. R. 73-74.

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[4] *Ross* v. *Commissioner,* 5 Cir., 227 F. 2d 265, 269.

[5] *Malat* v. *Riddell,* 383 U.S. 569, 572.

Just as in *Arrowsmith* the liquidation fixed the character of the transaction as a long-term capital gain, so too did the sale of the Gordon Contract in 1955, and the capital gain treatment accorded by the Commissioner for that year, fix the nature of the transaction. And, under *Arrowsmith,* once the character of the transaction has been determined, all subsequent transactions with respect thereto are of the same character..

Respondent's Memorandum in Opposition contains the following paragraph (p. 8):

> In the present case the Commissioner did precisely what this Court approved in *Arrowsmith.* He did not attempt to reopen the returns for 1955 and 1956, for which the limitations period had run, but examined the events of those earlier years in determining the character of resulting payments received in the later years.

Contrary to the above statement, the Commissioner in the instant case did precisely what this Court held could not be done in *Arrowsmith.* In *Arrowsmith* the taxpayer urged upon this Court that notwithstanding the original transaction involving liquidation of a corporation and treatment of the resulting gain as gain from the sale or exchange of a capital asset, a later judgment against the liquidated corporation which the taxpayer, as transferee, was required to assume should be treated as an ordinary loss rather than a capital loss. This Court held that the character of the transaction was fixed at the time of the liquidation of the corporation as gain on a sale or exchange of a capital asset; that any subsequent transaction which related to the liquidated corporation, whether income or deduction, had the same character as that originally

determined; and hence the loss in question was a capital loss and not an ordinary loss.

Factually, the instant case is stronger than was *Arrowsmith*. The reasons for the dissents in *Arrowsmith* do not exist here since at the time of the installment sale (1955 in the case of the Gordon Contract), there was no uncertainty as to the installment payments which were to be made in subsequent years. On the contrary, in *Arrowsmith* at the time of complete liquidation and distribution of the corporate assets, subject to its liabilities, there was no means of knowing what, if any, additional assets or additional liabilities might thereafter come to light, and if so, when. If the decision below stands, we will have the anomalous situation where the sale in 1955 was a capital gain transaction but installment collections on that sale, received in the years before the Court, represented ordinary income. In light of the popularity and volume of installment sales, it should not be required of a selling taxpayer that he qualify the sale as a capital gain transaction, not only in the year of sale, but as to each subsequent installment collection in each succeeding year.

Arrowsmith v. *Commissioner*, 344 U.S. 6, was decided in 1952. A petition for rehearing was denied, 344 U.S. 900. Since that time this Court has never found any occasion to overrule or even modify the decision. If the decision below is allowed to stand, *Arrowsmith* will in effect have been nullified by the Tax Court, with the approval of the Fourth Circuit, by completely disregarding the principle that the nature of the sale of the Gordon Contract in 1955 was fixed as the sale of a capital asset. It was so reported by the taxpayer; and it was so accepted by the Com-

missioner—in fact he recomputed the amount of capital gain in a reduced amount, and made a refund of tax for that year.

On the principle laid down in *Arrowsmith,* without more, the decision of the Tax Court, as approved by the Circuit Court, clearly should be reversed.

For that reason alone it is urged that the Petition for a Writ of Certiorari should be granted.

As an additional reason for granting the writ, in light of the decisions by the Seventh, Eighth and Ninth Circuits which uniformly applied the principles of *Malat* v. *Riddell,* and the conflict between those decisions and that of the Fourth Circuit in the case at bar, justice will best be served and further litigation avoided by granting this petition.

Respectfully submitted,

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